Letter To Our Shareholders

October 31, 2021

Excerpted from the Harding, Loevner Funds, Inc. 2021 Annual Report and Commentary

David Loevner, CFA
Chairman and Chief Executive Officer

Ferrill Roll, CFA
Chief Investment Officer

Simon Hallett, CFA
Vice Chairman

The fiscal year just ended began with two market-moving events that continue to reverberate: one, the approval of the first COVID-19 vaccine, delivered a positive shock. It launched an immediate resurgence in the stocks of more cyclical, more leveraged, and slower-growing companies whose beaten-down share prices had fallen far behind those of rapidly growing, high-quality companies since the onset of the pandemic, but whose prospects now brightened. We wrote in our letter to you a year ago of our skepticism concerning the much-ballyhooed demise of value investing but could not have anticipated how quickly the tables would turn. The renewed attention to cheaper stocks of companies with murky growth prospects has been a headwind for our investment strategies for much of these last twelve months, with returns of the respective "value" indexes significantly outpacing those of the corresponding "growth" indexes. We have delivered a mixed set of results relative to the strong returns of the broad market benchmarks in the year. But, given the headwinds for our growth-oriented investment style, turning in results close to those of the benchmarks, let alone modest outperformance, is a welcome relief.

The other event was a *negative* shock to markets: the eleventh-hour quashing by China's regulators of the huge initial public offering of Ant Financial, the fintech affiliate of e-commerce giant Alibaba. Though not apparent at the time, the scuppering of Ant's IPO turned out to be the first of a succession of jump scares in the shape of unexpected Chinese governmental interventions that progressively soured sentiment toward Chinese stocks. The regulatory assault on the for-profit tutoring industry vaporized the equity value of an entire industry in the summer. Anti-trust sanctions, data security requirements, and tighter restrictions on online gaming by minors came hard and fast in the following months, hitting the shares of many of China's previous market darlings in e-commerce, ridesharing, online games, and social media.

The property sector has played an outsized role in China's economy for many years, as a key driver of capital spending and employment growth and as a major store of wealth, accounting for 70% to 80% of household wealth according to Moody's. (Even in the home-ownership-obsessed US, the comparable figure is only 50%.) The government's efforts to de-emphasize fixed asset investment as the main source of economic growth, including shrinking its bloated property sector, may yet deliver the biggest horror scene of all. A tightening of financial regulations in December 2020 finally caught up with Chinese property developers. China Evergrande, the country's second-largest developer by sales and a poster child for excessive leverage, was left scrambling to meet its obligations by the end of September (and ultimately defaulted), with the effects rippling out to building supply chains, the financial and industrial sectors, and retail spending.

Naturally, such perturbing of the economy and consequent roiling of the Chinese stock and credit markets brought out a mix of opinions in the investor community, from cries of Communist Party treachery to post hoc social justifications for the swingeing actions taken by government actors. As those who know our investment culture would expect, our colleagues offered their own wide range of opinion and analysis. Our embrace of dissent is displayed in a panel discussion among six colleagues in August, as well as in the Third Quarter 2021 investment reports for eight of our strategies.

We have resisted any temptation to follow those critics who have advised turning away from China as an investment destination. We made our view of the long-term opportunity clear by launching the Chinese Equity Portfolio, our first single-country fund, last year; the events of this year have, if anything, reinforced our view that some investors will want the means to regulate their exposure to the opportunities and risks in the largest emerging market independently.

The irony is that amid the disquieting regulatory changes we are finding more high-quality businesses in China that meet our investment criteria now than at any point in our firm's history. Descriptions of such companies are sprinkled throughout the commentaries collected in this report. What the turmoil *has* done is renewed our analysts' investigation of the forces—including regulatory forces—shaping the competitive industry structures for the Chinese companies we research and own. We've spent time trying to grasp the long-term goals behind the regulatory interventions and concluded that a number of these goals—reducing wealth disparities, promoting healthier lifestyles, curbing the lopsided economic power for the very largest and most disruptive companies in China that might challenge the political power centers and social norms—would not, on their face, be out of place in the US or other developed markets. In short, we view the parsing of issues and risks for Chinese companies as problems

of analysis that are common to varying degrees to all companies. Many businesses worldwide are subject to regulatory fiat in one form or another and thus exposed to shifts in the regulatory winds; we believe that our fundamental process acquits itself well in discriminating between degrees of risk. Whether intentional or not, Chinese regulators have certainly succeeded in blowing the froth off the top of the Chinese stock market. We believe the more risk-aware environment in China should reward our sustained quest to identify companies with resilient businesses and strong growth prospects.

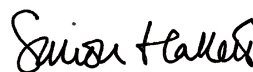
With widening access to vaccines and new drug treatments fostering a return to more normal economic activity in many countries, and the spread between the prices of the most- and least-expensive quintiles of stocks diminishing in most markets, there are indications that indifference to price and risk may be losing its fizz globally as well. Assuming the style headwinds eventually settle down, this more grounded approach to assessing value should advantage our focus on the business fundamentals enabling companies' long-term growth. Still, with the challenge of nascent inflation and the potential for central banks acting to counter it, not to mention the pandemic's undiminished ability to deliver unpleasant surprises, we look ahead to the coming year with a cautious eye.

As always, we thank you for your trust in us.

Sincerely,

David R. Loevner, CFA

Ferrill D. Roll, CFA



Simon Hallett, CFA

Opinions expressed are those of Harding Loevner and are not intended to be forecasts of future events, a guarantee of future results, nor investment advice. Please read the separate disclosure page for important information, including the risks of investing in the Portfolios. Past performance is not a guarantee of future results.